5/18/88 R9050-3

TAX FOUNDATION'S VOL. 32, NO. 3 APRIL/MAY 1988

TAX·FEATURES

Tax Freedom Day 1988 Is May 5; Two Days Later Than 1987

Workers Lose Two More Minutes Of a Day's Pay to Tax Bite

Another perspective on the tax burden is revealed by the tax bite in the typical worker's 8-hour day. In 1988, that worker will spend 2 hours and 45 minutes on the job for the tax collector, two minutes more than in 1987, and the largest tax bite since U.S. tax statistics began to be recorded early in this century. Of that period,

(Continued on page 2)

Tax Freedom Day and Tax Bite in 8-Hour Day

Year	Tax Freedom Day	Tax Bite in the Eight-Hour Day		
		Total	Federal	State/ Local
1955	April-9	2:09	1:34	0:35
1956	April-11	2:13	1:37	0:36
1957	April-13	2:14	1:37	0:37
1958	April-10	2:12	1:32	0:40
1959	April-14	2:16	1:36	0:40
1960	April-17	2:22	1:40	0:42
1961	April-18	2:22	1:38	0:44
1962	April-18	2:21	1:38	0:43
1963	April-19	2:23	1:39	0:44
1964	April-15	2:18	1:33	0:45
1965	April-15	2:17	1:33	0:44
1966	April-18	2:21	1:36	0:45
1967	April-20	2:24	1:37	0:47
1968	April-25	2:32	1:39	0:53
1969	May-1	2:38	1:48	0:50
1970	April-28	2:34	1:40	0:54
1971	April-25	2:31	1:36	0:55
1972	April-29	2:36	1:39	0:57
1973	April-29	2:36	1:41	0:55
1974	May-3	2:41	1:45	0:56
1975	April-28	2:35	1:38	0:57
1976	May-1	2:40	1:42	0:58
1977	May-3	2:41	1:43	0:58
1978	May-3	2:41	1:45	0:56
1979	May-3	2:41	1:48	0:53
1980	May-1	2:39	1:48	0:51
1981	May-4	2:43	1:52	0:51
1982	May-3	2:41	1:48	0:53
1983	April-30	2:38	1:43	0:55
1984	April-28	2:36	1:42	0:54
1985	April-30	2:38	1:44	0:54
1986	April-30	2:38	1:43	0:55
1987	May-4	2:43	1:48	0:55
1988	May-5	2:45	1:50	0:55

Source: Department of Commerce, Bureau of Economic Analysis; and Tax Foundation computations.

The bad news is that Tax Freedom Day 1988 is May 5. The worse news is that, although Tax Freedom Day last year was May 4th, this year's date is two days later than 1987 because 1988 is leap year.

Economists at the Tax Foundation announced today that the average American would work from January 1 through May 4 to furnish Federal, state and local tax collectors with the funds to pay all taxes, if every cent earned from the first of the year went for taxes. On May 5, Americans finally start working for themselves.

Put another way, it will take 126 days to satisfy the tax man this year, two days longer than were required last year. This way of expressing the tax load is calculated on the assumption that, sooner or later, the American "worker" ultimately pays the total tax burden — including business taxes which are passed on to individuals — in his or her capacity as an employee, proprietor, or investor.

Uncle Sam did it, counsel economists at the Washington-based tax watchdog organization.

(Continued on page 2)

THIS ISSUE:

PAGE 1:
Tax Freedom Day

Tax Bite in The 8-Hour Day

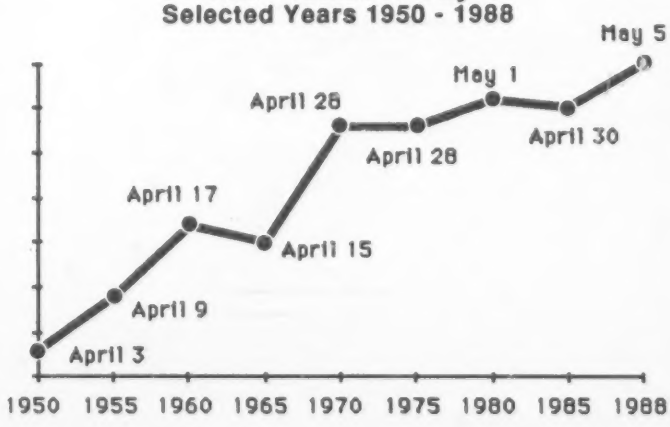
PAGE 3:
"Budget Watch"

PAGE 4:
Worker's Tax Dollar in '88

PAGE 5:
"Front Burner"

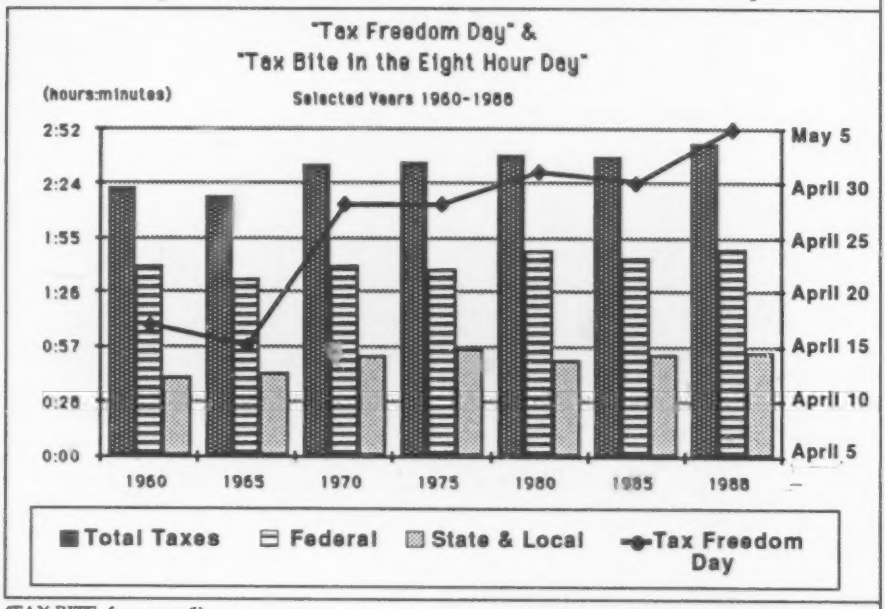
INSERT:
"State Tax & Fiscal Prospects"

Tax Freedom Day
Selected Years 1950 - 1988



(TAX FREEDOM DAY, *from page 1*)

Increases in the corporate income tax passed in the Tax Reform Act of 1986 (TRA86) are continuing to kick in; the Omnibus Budget Reconciliation Act of 1987 has loaded an estimated $9.1 billion on taxpayers; a large increase in social insurance taxes has taken hold; and the Continuing Resolution for 1988 increased Federal receipts an estimated $2.4 billion this year, taking an additional $1 billion from individual income taxes alone. Combined, the '87 Reconciliation Act and the '88 Continuing Resolution have boosted the 1988 Federal take by $11.5 billion.



The U.S. taxpayer has now lost all the ground gained through the major cuts of the Economic Recovery Tax Act of 1981 (ERTA). Since ERTA, large revenue raisers in 1982, 1983, and 1984, plus the 1987 omnibus bill and the 1988 continuing resolution, have lopped off big chunks of the '81 cuts and social security hikes have made further inroads, until, like the Cheshire Cat in Alice in Wonderland, nothing remains but the smile.

State/local taxes will increase in 1988, but not faster than the economy as they did over the previous six years. Also, the states receive an ongoing windfall as the effects of TRA86 continue to make state levies generally more progressive. Although some states changed their laws to avoid such windfalls, others opted to keep revenue gains, and they will rake in an estimated $1.1 billion extra this year.

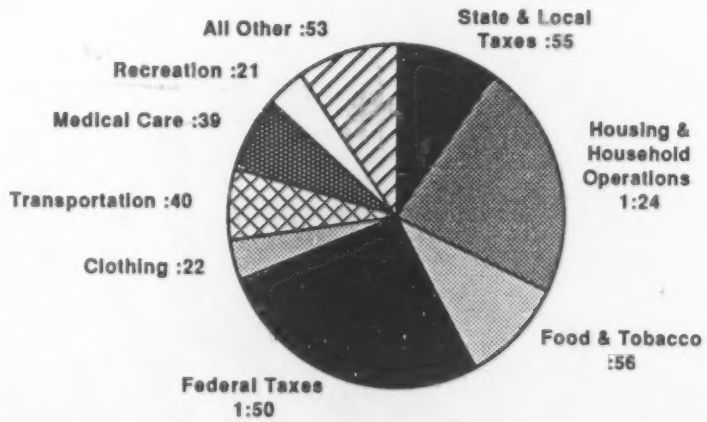
Tax Freedom Day grows later. In 1930, it fell on February 13. By 1940, it had moved to March 8, and to April 3 by 1950. In 1980, it coincided with May Day, and after a few years of relief under the 1981 tax cuts, it renewed its march further intoMay.

(TAX BITE, *from page 1*)

1hour 50 minutes goes to Washington, and 55 minutes go to states and municipalities, say economists at the Foundation.

As the accompanying table shows, the extra allocation for the two minute tax boost comes from the "Food and Tobacco" and "Clothing" categories, which lost 2 minutes and 1 minute, respectively, while the "All Other" category (personal care, personal business, private education, religious and welfare activities, net foreign travel, and net savings) will require an additional minute's labor.

In sum, what the average consumer managed to save on the price of clothes, food and smokes, was gobbled up by the tax collector.



"Tax Bite In the Eight-Hour Day"
1987 - 1988
(hours:minutes)

	1987	1988
Total Taxes	2:43	2:45
Federal	1:48	1:50
State and Local	:55	:55
Personal Consumption Expenditures	5:17	5:15
Housing and Household Operations	1:24	1:24
Food and Tobacco	:58	:56
Transportation	:40	:40
Medical Care	:39	:39
Clothing	:23	:22
Recreation	:21	:21
All Other	:52	:53
8-Hour Day	8:00	8:00

Budget Watch By Allen Schick

The Defense Roller Coaster

Budgeting has never been a calm, stable activity for the Pentagon. More than any other federal agency, its budget goes through wide swings. In the past, the defense budget cycle usually reflected changes in military conditions. War brought an escalation in defense spending; peace led to a decline. In the 1980s, however, the cycle has been influenced more by political than military factors.

The vicissitudes in the defense budget are starkly displayed in the table that accompanies this article. Between 1979 and 1985, the money provided for national defense (including some funds spent outside the Pentagon) soared from $126 billion to $294 billion, making this the biggest peacetime buildup in U.S. history. Since then, however, defense spending has been virtually frozen; in real (inflation-adjusted) dollars, national defense will get $35 billion less in fiscal 1989 than it received four years earlier.

These zigzags correspond to shifts in public opinion. Most Americans (58% in a Gallup Poll) favored the defense buildup at the start of the 1980s; most (80% in a recent poll) now think that defense spending should remain about the same or be decreased.

What the Money Bought

When the political cycle swings in favor of defense, the Pentagon goes on a buying spree, acquiring as many new weapons and forces as possible. The early 1980s conformed to this pattern. During the buildup phase of the cycle, the portion of the defense budget allocated to procurement rose from 25% to 33%. This behavior has often been criticized as wasteful, but it is mostly due to defense's boom and bust budgets. There are three main reasons why this cycle skews spending in favor of big ticket purchases.

When defense spending is depressed, the research phase is stretched out because the Defense Department doesn't have sufficient funds to acquire the weapons it has been developing. Then, when spending moves upward, it faces pent-up demand for procurement;

The Pentagon knows that if it does not obtain additional funds when support is high, it will not be able to do so when the cycle turns. Investing in weapons is its characteristic way of adjusting to the instability of the process.

Adjusting to the Downturn

Although it cannot know how long the current downturn will persist, the Defense Department must now adapt to more austere circumstances. The adjustment has been eased by the accumulation of more than $250 billion in carryover balances, funds appropriated in prior years but not yet spent. These balances have made it possible to maintain high production levels. But they also have made the defense budget more rigid: 40% of defense outlays now result from obligations incurred in previous years. When personnel and related costs are included, about 85 cents out of every defense dollar is locked into hard-to-control expenses.

If the downtrend in spending is prolonged, the Pentagon will not be able to count on carryover funds to tide it over until better times return. The typical way of adjusting to this situation has been to stretch out military procurement (buying fewer tanks, planes, and ships), to draw down on ordinance and spare parts, and to cutback on training and military readiness. This approach has the advantage of enabling the Department

(Continued on page 8)

The Defense Budget
Fiscal Years
Dollar Figures in Billions

	1979	1985	1989 est.
New budget authority	$ 126.5	$ 294.7	$ 299.5
Real (inflation-adjusted budget authority)	208.9	325.5	290.8
Total outlays	116.3	252.7	294.0
Defense Spending by Category (percent)			
Military personnel	29.7%	23.0%	26.2%
Operations and maintenance	30.1	26.4	28.6
Procurement	24.8	32.8	26.7
Research and development	9.6	10.6	12.8
Other	5.3	7.1	5.7

Major weapons have long lead-times stretching to as much as a decade. Despite the long lead times, Congress makes annual budget decisions for defense. Each year's appropriations depend on that year's political mood. It is difficult, therefore, to plan an orderly research-development-acquisition process, because the Pentagon does not know how much support it will have in Congress when the weapons are ripe for procurement.

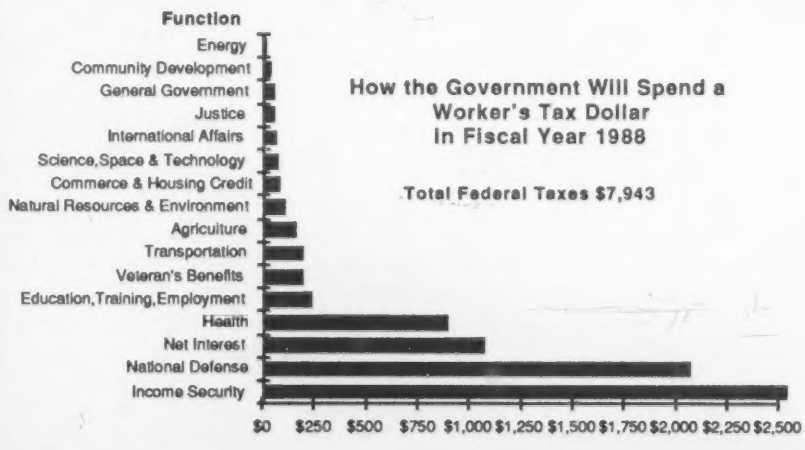
Because of these cyclical factors, the share of defense spending allocated to research and development declined during the early years of the Reagan buildup. In recent years, however, R & D has substantially increased its share. This suggested that the Pentagon is developing a new generation of weapons which will be ready when the next escalation in spending occurs.

Moderate Income American Family Will Pay Total Federal Taxes of $7,943 in Fiscal 1988

How the Federal Government Will Spend a Worker's Tax Dollar in Fiscal Year 1988(a)

Function	Worker's Share: Amount	Worker's Share: Percent of Total	Total Spending ($Millions)
Income Security (b)	$ 2,540	31.98	$ 349,277
National Defense	2,076	26.14	285,423
Net Interest	1,075	13.54	147,871
Health (c)	897	11.29	123,336
Education, Training, Employment, and Social Services	245	3.08	33,652
Veterans' Benefits and Services	202	2.54	27,748
Transportation	198	2.49	27,237
Agriculture	163	2.05	22,352
Natural Resources and Environment	110	1.39	15,139
Commerce and Housing Credit	90	1.13	12,364
General Science, Space, and Technology	79	0.99	10,903
International Affairs	72	0.91	9,926
Administration of Justice	65	0.82	8,970
General Government	64	0.81	8,796
Community and Regional Development	46	0.58	6,321
Energy	20	0.25	2,713
Total (d)	$ 7,943	100.00	$ 1,055,904
Exhibit:			
Payments for Individuals	$ 3,628	45.68	$ 498,867

(a) In this example, the worker is the sole source of support for a spouse and two dependent children earning $ 30,000 per year.
(b) Includes social security, Federal employee retirement, unemployment compensation, housing assistance, and food and nutrition assistance; excludes veteran's income security.
(c) Includes Medicare, Medicaid, and others; excludes veterans' hospital and medical care.
(d) After deducting $ 36,123 million in undistributed offsetting receipts not classified by function.
Source: Tax Foundation computations, based on Fiscal Year 1989 U.S. Budget presented February 18, 1988 and tax laws for 1988 from the Treasury Department.



How the Government Will Spend a Worker's Tax Dollar in Fiscal Year 1988

Total Federal Taxes $7,943

A moderate-income family—one worker earning $30,000 with a spouse and two dependent children faces a tax bill of $7,943 for fiscal year 1988. That covers the family's direct as well as indirect Federal taxes. Add to this their $1,316 share of the Federal deficit, and the family will pay $9,259 to support the estimated $1.06 trillion Uncle Sam plans to spend in fiscal year 1988.

Economists at the Tax Foundation use this prototypical family to show where the average American household's tax dollars will go. Assuming that the $7,943 tax bill is allocated to cover the family's whole share of Federal spending, the following expenditures stand out.

Income security costs the most at $349.3 billion. This comprises Social Security, Federal retirement, unemployment compensation, housing assistance and nutrition assistance. The Federal government will pay out 32 cents for income security programs for each $1 this taxpayer sends to Washington, a total of $2,540.

National Defense will cost $285.4 billion-or 26 cents out of each tax dollar. For the moderate-income taxpayer described here, this amounts to $2,076.

Interest on the public debt ranks third at $147.9 billion, costing this worker over 13 cents of his tax dollar or a whopping $1,075.

Health outlays, mainly Medicare and Medicaid, will take over 11 cents of each tax dollar. This earner will send Uncle Sam $897 to pay for the $123.3 billion national health bill.

These four programs alone will claim almost 83 percent of all Federal spending and will cost this moderate-income taxpayer $6,588 in taxes.

However, direct levies do not explain the whole tax picture, accounting for only about three-fifths of the total Federal tax take. To these must be added such indirect taxes as

(Continued on page 5)

(WORKER'S TAX DOLLAR, *from page 4)*

employer's share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor and tobacco; and miscellaneous levies. These will take another $3,069 from the moderate-earner's paycheck.

Direct and indirect Federal taxes claim over 26 percent of this family's annual income. But even that does not tell the whole story. All told, current Federal taxes and borrowing add up to nearly 31 percent of this moderate-income family's earnings.

The accompanying table and chart provide further details.

Now Available

Facts & Figures on Government Finance 1988-89 Edition

Facts and Figures on Government Finance, the essential one-volume reference to Federal, state, and local taxing and spending is now avaiable.

For the first time in the volume's 47-year history, *Facts and Figures* is being brought to the public in cooperation with an outside publisher: The Johns Hopkins University Press.

283 tables. 368 pages.
$24.95 softcover. $30.00 clothbound.

Order From:

The Johns Hopkins University Press
701 West 40th Street, Suite 275
Baltimore, MD 21211

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Chairman of the Board ..... Hans W. Wanders
President ..... Robert C. Brown
Senior Vice President . Edward A. Sprague
Editor ..... William J. Wilson
Contributing Editor ..... Allen Schick
Contributing Economist ... Paul G. Merski
Consulting Economist .... Elsie M. Watters
Publications Specialist ..... William Ahern

Tax Foundation
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
(202) 822-9050

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Capital Gains Aren't Just for the Rich"

The following guest "Front Burner" first appeared as a Letter to the Editor in the Washington Post, March 26, 1988. It is reproduced with permission.

Your March 15 editorial on "Capital Gains and Fairness" sure made me mad! A Friend in Washington called and read the editorial to me, and I put this response to you in a purple airplane the next day so that he could drop it at your office while it was still hot.

Your statement that 50 percent of the capital gains go to upper-income people may be true, but that means that the other 50 percent goes to those of us in lower brackets. It doesn't take much of a tax increase to put us out of business. If we are going to talk fairness, it shouldn't matter whether you're rich or poor when it comes to how capital gains are taxed.

I just did my taxes, and your comments about millionaires hit me like salt on a sunburnt blister. I finally made a sale on some trees that I've been growing half a lifetime, and the new tax rates are taking 71 percent more of my income than under the old rules. That's a lot of money to me. It would replace my old pickup truck. It would reforest 150 acres of land. It would more than pay for the forestry consultant I hire to make sure my forest is in good shape. The topping on this bitter cake is that the paper work required to complete the process of being fleeced has more than doubled.

In spite of what the tax laws have done to me, I'm going to plant trees to replace those I've cut, and I'm going to hire foresters to keep my forest in prime condition. This farm goes back in my family a long time, and I want it to go forward for my family and others into the future.

I'll continue to take care of my land and send my money to Washington, but I'll feel like I've been treated badly. I've been planting and growing trees for 50 years now, and I've been through forest fires and tornadoes and droughts and ice storms, but the new tax laws are the biggest mess I've ever seen and the most discouraging to tree farmers. If the trend continues, we will eventually do all the work and take all the risks and then send all the money to Washington.

You mention that a bargain was stuck on taxes less than two years ago and that the bargain should not be broken. The deal you speak of is no bargain. It broke an implied commitment made to forest landowners more than 40 years ago, when the tax rates for long-term investments were lowered.

The more than 4 million American who own important tracts of forest land are unfairly treated under the new rules. These are ordinary folks, who sometimes wait a lifetime for some income from their forests. Many of them established their forests more than 40 years ago under that first "bargain" struck with Congress. The agreement at that time recognized that private forestry operations were risky, long-term investments, deserving of lower rate taxation of capital gains. There was also recognition that tax policy sets land-use policy and that if the nation approved of the conservation of private forests, a tax system that encouraged long-term investments would "put our money where our mouth was."

I think we landowners have kept our side of the long-term commitment. Although some forests certainly aren't as well cared for as I would like to see, overall we have planted billions of trees and constantly improved the application of forestry to the land. Most of us have done this work because we care about the land, but it sure helped to know that we got to keep some of our gains after years of work.

You use a lot of trees in putting out your paper, but your editorial ignored what it takes to grow those trees. Look outside Washington and the law books if you want to know what the system does.

C. M. Stripling
Camilla, GA

Sales Taxes Rake in Revenue for States

Sales taxes produce more revenue for the states than any other source, according to recent analysis by the Tax Foundation. Economists at the Washington-based tax watchdog organization say that in the 45 states which levy general sales taxes, $79.8 billion was brought in to state treasuries in fiscal year 1987 — almost a third (32.3%) of the $247.1 billion total state tax collections for that year.

The personal income tax ranked second, bringing in $76 billion during fiscal 1987 for 30.8% of total tax receipts, a hefty 12.7% increase over 1986's take. Corporate income taxes, the third largest single tax source, also showed a sizeable jump, amounting to $20.7 billion, 8.4% of the total. Only five states (Nevada, South Dakota, Texas, Washington, and Wyoming) have neither a corporate nor a personal income tax, and only seven states (the previous five plus Alaska and Florida) have no individual income tax.

All states tax gasoline and motor fuels; this source netted $15.7 billion, 6.3% of their total taxes in fiscal 1987.

Local property taxes are levied in all 50 states, and 39 have state property taxes; 39 states have both general sales and income taxes; and 33 states have general sales, income, and property taxes, Tax Foundation economists say.

State Sales Taxes

Connecticut led the list for top rates with its 7.5% sales and use tax rate, followed by: Washington (6.5%); Minnesota, Mississippi, New Jersey, Pennsylvania, Rhode Island, Florida and Texas (6%); and Nevada (5.75%). No state general sales tax is levied in Alaska, Delaware, Montana, New Hampshire, or Oregon, although municipalities in Alaska do impose sales tax.

The state sales tax is lowest — 3% — in four states: Colorado, Georgia, North Carolina, and Wyoming. Localities in 28 states levy sales taxes, generally in addition to those shown in the accompanying table.

Income Tax Rates

Minnesota (14%) and Iowa (13%) have the highest marginal individual income tax rates. The rate schedules are progressive (i.e., rise as income brackets go up) in all but five states. Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate, regardless of income level. In three states, income taxes are levied as a percentage of Federal individual income tax obligations — Nebraska, Rhode Island, and Vermont.

The maximum corporate income tax rates are highest in Iowa and Minnesota (12%); Connecticut (11.5%); Arizona and North Dakota (10.5%); and California (9.3%).

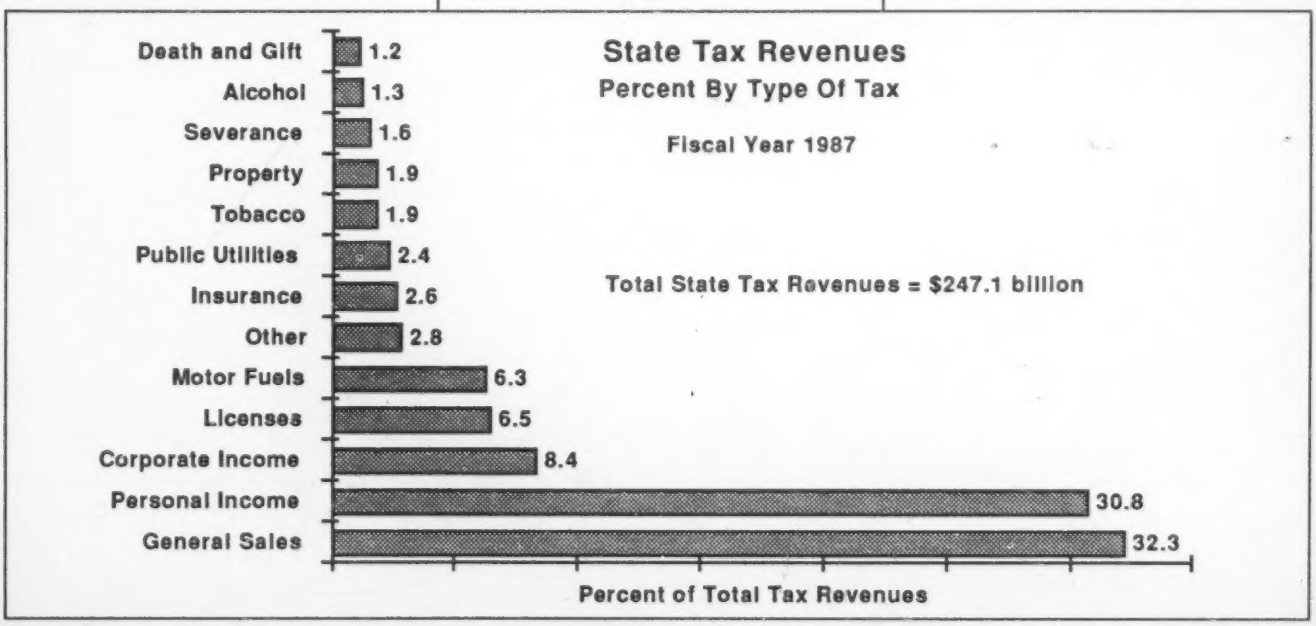
Gasoline Tax

Gasoline taxes are highest in Montana and Wisconsin (20 cents a gallon), Connecticut and Utah (19 cents) and Hawaii (where combined state-local rates range from 16 to 22.5 cents a gallon). The lowest rate — 4 cents — is levied in Florida, where gasoline is also subject to the general sales tax. The next lowest rate — 8 cents — applies in Alaska, New Jersey, New York, and Wyoming.

Cigarette Tax

Cigarette Taxes also make a notable contribution to state tax revenues, Tax Foundation economists report. In fiscal 1987, the states collected $4.6 billion, 2% of their total taxes, from tobacco products excises. Rates range from a high of 31 cents a pack in Washington to 2 cents in North Carolina.

The accompanying table gives details, as of April 1, 1988, for major taxes and rates prevailing in the states.



MAJOR STATE TAXES AND RATES, Reported through April 1, 1988

State	Income Taxes: Corporate	Income Taxes: Individual	General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Property Tax
Alabama	5%(F)	2 to 5%(F)	4%(a)	11 cents	16.5 cents	X
Arizona	2.5 to 10.5(F)	2 to 8(F)	5(a)	16	15	X
Arkansas	1 to 6	1 to 7	4(a)	13.5	21	X
California	9.3(q)	1 to 9.3(q)	4.75(a)	9	10	X
Colorado	5.5 to 6(b)	5(q)	3(a)	18(b)	20	X
Connecticut	11.5(c)	1 to 12(d)	7.5	19(e)	26	X
Georgia	6	1 to 6	3(a)	7.5 + 3% of retail	12	X
Hawaii	4.4 to 6.4	2.25 to 10(b)	4	15 to 22.5	40% wholesale	
Idaho	8	2 to 8.2	5	18	18	X
Illinois	4(p)	2.5	5(a)	13	20	X
Indiana	3.4(f)	3.4	5	15	15.5	X
Iowa	6 to 12(F,h,q)	.5 to 13(F)(q)	4(a)	18(e)	34(b)	
Kansas	4.5(g)	2 to 9(F)	4(a)	11	24	X
Kentucky	3 to 7.25	2 to 6(F,r)	5(a)	15(i,l)	3.001	X
Louisiana	4 to 8(F)	2 to 6(F)	4(a)	16	16	
Maine	3.5 to 8.93(q)	1 to 10	5	14	28	X
Maryland	7	2 to 5	5	18.5	13	X
Massachusetts	8.33(j)	5(k)	5	11	26	X
Michigan	2.35	4.6	4	15	25	X
Minnesota	9.5(q)	6 to 8(o,q)	6(a)	17	38	X
Mississippi	3 to 5	3 to 5	6	17(e)	18	X
Missouri	5(F)	1.5 to 6(F)	4.225(a,b)	11	13	X
Nebraska	4.75 to 6.65	2 to 5.9	4(a)	17.3(l)	27	
New Jersey	9(g)	2 to 3.5	6	8(e)	27	X
New Mexico	4.8 to 7.6	1.8 to 8.5	4.75(a)	14	15	X
New York	9(c)	3 to 8.375(b,s)	4(a)	8	21	
North Carolina	7	3 to 7	3(a)	15.8(l)	2	X
North Dakota	3 to 10.5(F)	2.67 to 12(F,m)	5.5(b)	17	27	X
Ohio	5.1 to 8.9(c)	.743 to 6.9	5(a)	14.7(l)	18	X
Oklahoma	5	.5 to 6(F,r)	4(a)	16	23	
Pennsylvania	8.5	2.1	6	12	18	X
Rhode Island	8(c)	22.96% of Federal income tax	6	15(i,l)	25	X
South Carolina	5.5(b)	3 to 7	5	15(e)	7	X
Tennessee	6	6(d)	5.5(a)	17	13	
Utah	5	2.75 to 7.75	5.094(a,b)	19	23	X
Vermont	5.5 to 8.25	25% of Federal income tax	4	13	17	X
Virginia	6	2 to 5.75	3.5(a)	17.5	2.5	X
West Virginia	9.75(b)	3 to 6.5(q)	5	10.5	17	
Wisconsin	7.9	4.9 to 6.93(q)	5(a)	20.9(l)	30	X
Florida	5.5(q)		6(a)	4	24	X
Nevada	These 5 states	These 7 states	5.75(a)	14.25(e)	20(b)	X
South Dakota	have no	have no	4(a)	18	23	
Texas	corporate	individual	6(a)	15	26	
Washington	income tax	income tax	6.5(a)	18	31	X
Wyoming			3(a)	8	8	X
Alaska	1 to 9.4(q)		These	8	16	X
Delaware	8.7	3.2 to 7.7(F,h)	5 states	16	14	
Montana	6.75(g,t)	2 to 11(F,n)	have no	20	16	X
New Hampshire	8	5(d)	general	14	17	X
Oregon	6.6	5 to 9(F,h)	sales tax	14(e)	27	X

(X) Indicates state levies a property tax.
(F) Allows Federal income tax as a deduction.

(a) Local taxes are additional.
(b) Future reduction scheduled under current law.
(c) Alternative methods of calculation may be required.
(d) In Connecticut, New Hampshire, and Tennessee, tax applies to income from intangibles only, at various rates according to type. In Connecticut, capital gains are taxed at 7%.
(e) Future increases scheduled under current law.
(f) A supplemental net income tax is imposed at 4.5%.
(g) Corporate surtax imposed: Kansas, 2.25%; Montana, 4%; New Jersey's rate is computed annually.
(h) Deductions limited.
(i) Tax imposed at percent of wholesale value.
(j) A 14% surtax is imposed on the sum of the income tax and a tax on net worth or tangible property not taxed locally.
(k) Tax of 10% on income derived from intangibles, and 5% on all other income.
(l) Tax rate is periodically adjusted administratively.
(m) Optional tax of 14% of taxpayer's adjusted Federal income tax liability.
(n) Additional 10% surtax is imposed for 1987.
(o) Plus 10% of Federal 15% rate and personal exemption phaseout for taxpayers above certain income levels.
(p) Additional 2.5% personal property replacement tax.
(q) Alternative minimum tax is imposed.
(r) Qualified taxpayers may elect to pay alternative taxes at varying rates.
(s) Separate tax is imposed on unearned income through 1988.
(t) 7% rate for corporations using water's edge apportionment.

Source: Compiled by Tax Foundation from data reported by Commerce Clearing House.

(BUDGET WATCH, *from page 3*)

to hold on to its force structure in the face of financial adversity. Fewer "buys" and a lower state of readiness come at a high price, however. Low rates of procurement drive up the cost per plane or tank; fewer flying hours and lower stocks of material leave the country unprepared if international conditions worsen.

The latest (fiscal 1989) budget deviates from the typical defense cutback. While it contains some stretchouts and savings, it adjusts to financial stringency by reducing force levels. Despite his strong support for defense, President Reagan's budget calls for deactivating several air wings, early retirement of ships, and a reduction in the number of military personnel. As a symbol of this retrenchment, the Navy has been compelled to surrender its objective of a 600-ship fleet.

Stabilizing the Defense Budget

There is widespread agreement that instability leads to inefficiency during both the up and down phases of the defense cycle. Surprisingly, the defense budget appears to be remarkably stable if the time frame is shifted from a single fiscal year to a generation or longer. Over an extended period, real defense rises about 1% a year, less than the growth rate of the economy or the federal budget.

To take advantage of this long-term stability, the Department has urged Congress to budget for defense on a multiyear basis. Thus far, Congress has shown no inclination to abandon annual appropriations, but it has taken a few modest steps to stabilize the defense budget.

In 1986, Congress directed the Pentagon to submit 2-year budgets. Congress has also authorized the Department to write multiyear procurement contracts for designated weapons, and to test an innovation known as "milestone budgeting" which provides for congressional review when predetermined stages in the development or the procurement process are reached. While these innovations help a bit, their application has been limited to only a small part of the defense budget.

Congress likes to keep the Pentagon on a short leash, and to exercise tight control through annual authorizations and appropriations. If it can't get relief from Congress, the Pentagon looks to the Bible for guidance. Remembering Joseph's dream of sevenfat years followed by sevenlean ones, the Department has adjusted to instability and carried on.

Tax Freedom Day Idea Was the Brainstorm Of a Florida Businessman

Dallas L. Hostetler, Executive Director of the Florida State Retailers Association, devised the idea of Tax Freedom Day in 1948. He was the first to come up with a way to indicate how long Americans had to work for the tax collector before they could begin to work for themselves.

The idea caught on. In 1950, the U.S. House of Representatives and the Senate passed concurrent resolutions resolving that, "Tax Freedom Holiday [as it was then known] be symbolized as a day of relief throughout the land, with such demonstrations as may seem appropriate, including prayer for deliverance." The Freedoms Foundation gave Hostetler its George Washington Honor Medal Award in 1950.

Hostetler retired in 1974, at the age of 72, and assigned the Tax Freedom Day concept to the Tax Foundation. The Foundation's economists were delighted to accept the offer, and to receive transmittal of the idea which Hostetler had registered with the U.S. Copyright Office in 1953.

It has turned out to be one of the most widely known information releases produced by the Foundation.

TAX FOUNDATION
One Thomas Circle, N.W., Suite 500, Washington, D.C. 20005

Ms. Jeanne Long
CONGRESSIONAL RESEARCH SERVICE, INC.
4500 East-West Highway
Bethesda, Maryland 20814

SPEC. REPORT

R9050-3

TAX FOUNDATION
ONE THOMAS CIRCLE, N.W.

SPECIAL REPORT

WASHINGTON, DC 20005
TELEPHONE (212) 822-9050

State Tax and Fiscal Prospects, 1988

By Elsie M. Watters
Consulting Economist
Tax Foundation

State legislatures this year face an extensive array of tax proposals, following a near-record volume of legislation in 1987. At least 28 of the 44 states holding regular sessions in 1988 will consider changes in one or more major taxes. (No legislative sessions are being held in Arkansas, Montana, Nevada, North Dakota, Oregon, and Texas.)

According to a Tax Foundation survey as of Mid-March, 22 states will seek higher taxes, with potential revenues totaling more than $4 billion annually. Six other states are weighing reductions, generally in small amounts adding up to under $200 million. The prospects for enactment of the bills pending, as well as potential revenue effects, are difficult to predict. It is an election year, when state officials are reluctant to impose higher taxes on their constituents; many proposals are somewhat nebulous; some require voter approval; and others lack strong legislative backing.

Deliberations in 1988 follow a year in which nearly all states with income taxes reexamined their tax structures vis-a-vis possible revenue changes that would automatically result from the 1986 revision of the Federal tax code. In addition, many states looked at nonincome taxes for new revenues. Altogether, 28 states last year sought to raise close to $8 billion annually in new revenue to balance ongoing budgets and pay for growing spending programs. It is estimated that $6 billion in higher taxes was enacted.

The 1988 tax increases are sought primarily to meet rising costs of improved local school programs; to finance continuing highway construction, maintenance, and repair; to strengthen medical care funding; and to balance generally rising budgets.

The most popular targets for new revenues this year are levies on motor fuels (increases are pending in 11 states), general sales (10 states), personal income (6 states), business profits (6 states), cigarettes (5 states), and alcoholic beverages (3 states).

The changes under consideration, by type of tax, are summarized below, followed by a state-by-state summary of proposed revisions.

General Sales Taxes. Ten states are weighing increases in general sales taxes, and three are considering slight reductions. Sales tax rate increases have been proposed in Michigan (sponsored by education groups for more equitable school financing), Missouri (for medical care), North Carolina (for local public school buildings), and West Virginia (for general budget balancing). Base-broadening measures extending the sales tax to cover items previously exempt, mostly some services, are being considered in Arizona, Colorado, Idaho, Louisiana (one proposal would remove *all* sales tax exemptions), Washington, and Wisconsin. Most base-broadening proposals involve extending the tax to a limited number of items. Florida's unsuccessful 1987 experience in attempting to expand the tax to cover a comprehensive range of services appears to have discouraged efforts in other states to gain large new sums from increasing the variety of items taxed.

In three states, proposals call for slight reductions in the sales tax. Some lawmakers in Connecticut have asked for the exemption of clothing items costing less than $100, as well as a rate reduction; the governor of Kansas wants to exempt new manufacturing machinery and equipment; and South Dakota repealed a one-cent temporary hike in the sales tax two months early.

Personal Income Taxes. Thirteen states are considering personal income tax revision this year. Six states are looking for new revenues from the changes; three states may reduce income taxes; and in four states the revisions would be neutral.

Increases in personal income taxes are pending in Alabama, Illinois, Kentucky, Massachusetts, Missouri, and Wisconsin. Some legislative leaders in Alabama want to raise income taxes to gain an additional $304 million for higher state spending. Illinois' governor has indicated strong support for income tax increases to support a more generous state budget. In Kentucky, where the legislature did not meet in 1987, some lawmakers want to conform the state tax to the new Federal code in order to gain new state revenue. Massachusetts lawmakers will also consider conformity to the Federal law, to raise $74 million in new revenue. Missouri is expected to consider 7 1/2% surcharges on income taxes; and some Wisconsin legislators seek repeal of the state's 60% capital gains exclusion that was retained last year in a comprehensive tax revision.

Personal income tax reductions are pending in Kansas, Oklahoma, and Vermont. Kansas may return all or part of the "windfall" resulting from Federal tax revision. Oklahoma may restore the extra personal exemption for the low-income elderly, along with cutting the top marginal rate for those who deduct Federal taxes in computing state tax liability. The governor of Vermont recommended a temporary cut in the tax rate, as well as an earned income tax

Copyright 1988 by the Tax Foundation , One Thomas Circle, N.W., Suite 500, Washington, DC 20005 (202) 822-9050

credit.

Business Taxes. At least ten states are deliberating changes in business income taxes. Proposals in six states would result in higher taxes: Idaho (repeal of the investment tax credit), Illinois (rate increase); Louisiana (broaden base), Missouri (7 1/2% surcharge); South Dakota (impose a corporate tax); and Wisconsin (tax unrelated business income of tax-exempt organizations).

On the other hand, business tax reductions may be made in four states: Michigan and New Hampshire may ease business profits taxes; proposals in Pennsylvania would lower the capital stock and franchise tax and the utility gross receipts tax; and Rhode Island has already approved repeal of its corporate net worth tax.

Motor Fuels Taxes. Higher motor fuels taxes, primarily to support highway needs, continue to be a major target for legislation in states where rates are not administratively determined. Eleven states are expected to consider hikes in motor fuels taxes in 1988. Increases have already been enacted in Indiana and South Dakota. Other states include: Colorado, Idaho, Iowa, Maine, Minnesota, Vermont, Washington, West Virginia, and Wisconsin.

Other Taxes. Relatively few changes are under consideration for cigarette and alcoholic beverage taxes. Five states may raise cigarette tax rates: Iowa, Louisiana, Rhode Island, West Virginia, and Wyoming. Increases in some alcoholic beverage products are being discussed in Hawaii, Iowa, and Wyoming.

Apart from their consideration of state tax changes, the legislatures in four states have on their agenda the comprehensive statewide reform of local property taxes. The reforms generally seek greater equity among types of taxpayers, as well as reduction of local property tax burdens. States considering such revisions are Minnesota, Oklahoma, Wisconsin, and Wyoming.

Selected State Reports

Alabama. Legislative issues this year are focused on ways to increase funding for schools. The governor presented a balanced budget, asking for no tax increases, but for transfers of some earmarked funds to the general fund (88% of Alabama's revenues are dedicated to specific functions). He said that in 1989 the state should tackle tax reform, but "this year education should require our attention." On the other hand, the speaker of the house holds that tax revenues must be increased this year to meet education needs, and is seeking a $307 million state tax increase through revisions in the personal income tax.

Arizona. In his state of the state address, the governor said that he would not support any tax rate increases; several weeks later, however, he proposed a $93.9 million revenue increase to balance the budget for fiscal 1989. Under consideration in the legislature are broadening the sales tax base and reforming the personal income tax.

Colorado. Although the governor has proposed close to $1 billion in higher taxes, the legislature is reportedly not receiving these recommendation with favor. Among the governor's tax proposals are broadening the sales tax base, increasing the gasoline tax, and raising registration fees.

Connecticut. The governor recommended no tax increases or reductions. Some legislative leaders, however, have proposed repealing the two-cent gasoline tax increase approved last year and exempting articles of clothing priced at $100 or less from the 7.5% sales tax. Another proposal would cut the sales tax rate to 7%.

Florida. No significant tax changes are expected in Florida this year.

Hawaii. The legislature may consider increasing alcoholic beverage tax rates and a new conveyance tax, the latter as part of the governor's initiative to establish a housing fund for rental assistance. The outlook for passage is said to be tenuous. The governor is opposing attempts to return the state's $400 million budget surplus to the taxpayers; instead, he wants to use the funds to finance several new state programs, including housing.

Idaho. The governor proposed several tax increase measures, including repeal of the investment tax credit, raising motor fuels tax rates, broadening the sales tax base by eliminating the trade-in exemption and extending the tax to auto and other repair services, and establishing a flat 3% insurance tax. The legislature is reportedly unwilling to approve any of the proposals, except perhaps the motor fuels tax increase.

Indiana. The legislature adjourned February 29, after enacting an increase in the gasoline tax and authorizing the state to issue highway bonds for the first time. Lawmakers also raised the diesel fuel tax and increased a truck fuel surcharge, to replace a truck tax that had been ruled unconstitutional. Because of recent, unexplained, declines in revenue collections, there is speculation that the 1989 surplus will be substantially lower than previously estimated, and there is a strong likelihood of pressure for tax increases or budget cuts in the 1989 session.

Iowa. The legislature is considering tax increases to avoid a potential $150 million budget deficit. Under consideration are proposals to tax wine coolers at $1.75 a gallon and to raise motor fuels tax rates. Lawmakers have already approved an increase in the cigarette tax from 26 cents to 34 cents a pack. Opinion in the legislature is divided as to whether to make permanent the temporary (one-year) income tax code changes enacted last year, or to simply extend the 1987 changes for one more year.

Kansas. Instead of continuing to retain the "windfall" revenues from Federal tax revision, as the state did in 1987, the governor asked for revision of the personal income tax so as to return about 40% of the "windfall". He also proposed major reforms in the business tax code, including exempting purchases of new manufacturing machinery

and equipment from the sales tax, and changing the method of taxing multinational corporations headquartered in Kansas. Although lawmakers reportedly were generally receptive to the governor's plan, the senate majority leader proposed returning to the taxpayers all of the "windfall" gain.

Kentucky. The governor said that his budget would require no additional taxes. Many lawmakers, however, prefer to raise taxes rather than cut spending, and would like to revise the state income tax to gain revenue by conforming to the new Federal tax code. Lawmakers did not convene in 1987, and this year represents their first opportunity to consider Federal conformity. (The governor is said to be adamantly opposed to income tax conformity.)

Louisiana. The new governor has called a special session of the legislature for March 21 to consider the state's acute financial situation (the regular session convenes April 18.) Numerous proposals for tax changes have surfaced, designed to raise new revenues and to reform the state's tax system. Some suggestions would remove all sales tax exemptions (for new revenue of $450 million), raise the tobacco tax, impose a flat 4% rate on personal income, and broaden the base of personal and corporate income taxes. The budget deficit in 1988 is estimated at $330 million, and follows accumulated deficits in the two prior years totaling $445 million. Based on financing current programs and revenue projections, there would be a $700 million deficit for fiscal 1989. (Louisiana's constitution requires that the legislature enact a balanced budget, but not that the state end with one.)

Maine. The governor asked for a 5-cent increase in the gasoline tax, along with reform of the income tax system by broadening the tax base, simplifying the bracket structure, and reducing rates. He also recommended tax rebates totaling $17 million to compensate taxpayers for a windfall of higher state taxes in the last half of 1987 resulting from Federal tax changes.

Massachusetts. To circumvent potential deficits in both fiscal 1988 and 1989, lawmakers are expected to consider measures to add $264 million to 1989 tax collections. One of the proposals would conform the state income tax to the new Federal income tax code, to raise an estimated $74 million. Minor technical changes in tax laws, along with more enforcement resources, account for the rest of the revenue-raising package. Another major issue before the Massachusetts legislature, a carry-over from 1987, is health care financing, including a proposal to provide universal health insurance.

Michigan. The governor proposed closing various tax loopholes and reducing the property tax burden. Last year, the legislature revised the personal income tax to return the "windfall" from Federal tax revision to taxpayers; this year consideration may be given to cutting some business taxes. Legislation already enacted this year will exempt from personal income tax those earning less than $1,500 a year (the law will primarily affect children, who became subject to tax when Michigan adopted the new Federal code). There are proposals in Michigan, backed primarily by school groups, to raise the sales tax to gain an additional $700 million to $1,400 million, earmarked for public education. (Such a change would require a popular vote, because the sales tax rate is set in the constitution.) The sales tax increase proposal is an attempt to deal with per pupil disparities among local school districts and the high reliance on property taxes to fund public education.

Minnesota. Last year, the state concentrated on income tax revision; this year the major issue before the legislature is revision and reform of property taxes. The governor proposed measure that would cut property taxes for commercial and industrial property, give tax relief to high-tax cities, increase local government aid, and simplify the state's classified property system by reducing the number of property classes from 68 to 4. The administration hopes to pay for the reforms, which would cost an estimated $200 million over two years, by relying on new revenues from economic growth. The legislature is also considering an increase in the state gasoline tax.

Mississippi. No legislative tax changes are expected. The governor proposed a $198.7 million spending increase for education, to be paid for by a combination of new revenue growth, budget cuts, bond programs, and surplus cash reserves.

Missouri. Tax proposals include raising the sales tax by 3/8%; and imposing 7 1/2% surcharges on personal and corporate income taxes, for new money of $150 million and $75 million, respectively. These and other increases are sought to provide a portion of the funding for a proposed "medassist" plan. In addition, more than 80 bills have been introduced that would affect taxes in some way.

Montana. No legislative session is to be held in 1988.

Nebraska. Stating that the condition of the state is "measurably improved" in the last 12 months, the governor outlined new education funding and other spending plans, and stressed that she believed it vital to avoid new taxes. She also suggested a study to determine a "constitutional and equitable" formula for evaluating farm land values for tax purposes. Doubts have been expressed by some legislators as to whether the governor's spending plan exceeds available revenue in the second half of the current biennium.

New Hampshire. Some lawmakers are seeking a reduction in the business profits tax from 8% to 7 1/2% or 7%. (A similar proposal failed to pass last year.)

New Jersey. The governor proposed that the state sponsor a foreign sales corporation so that the state's small- and medium-sized businesses could qualify for Federal tax breaks. (On January 19, 1988, the governor signed a bill raising state motor fuels taxes, passed by the 1987 legislature.)

New York. The governor proposed no new taxes, but

suggested some revisions in sales taxes and estate and gift taxes, as well as the imposition of a new solid waste disposal fee to help close municipal landfills. He also stressed the importance, in his view, of adhering to tax cuts previously enacted.

North Carolina. The legislature will convene June 2, in what is expected to be a short budget session. Among tax measures to be considered, carried over from 1987, is an increase in the state sales tax by 1%, with proceeds earmarked for public school buildings.

Ohio. The governor did not propose any tax changes in this "off-year" legislative session, and no major tax changes are anticipated. Legislative leaders have predicted that higher taxes will be enacted next year.

Oklahoma. The governor suggested changes in the personal income tax, in addition to those made last year. He would restore a $1,000 exemption for the elderly that was dropped in 1987 (but would limit it to lower-income taxpayers) and would reduce the tax rate for those who deduct Federal taxes in computing state tax liability. The legislature is expected to consider revamping the ad valorem tax system to allow assessments at 100% of market value, instead of 55% as at present, and to remove millage caps in the constitution. Lawmakers may also consider a flat 2% tax on casualty insurance gross premiums, which would raise about $7 million.

Oregon. The legislature is not meeting this year. A voter-instigated initiative to make the present statutory spending limitation constitutional is under way, and may appear on the November 1988 ballot. Pennsylvania. The governor said in his budget address that he will not support any increases in state taxes. Last fall, however, he presented a bill to a special session of the legislature that would substantially liberalize the authority of local governments to impose income taxes. Some legislative leaders are seeking reductions in two business taxes, totaling $98 million annually; they would cut the rate of the capital stock and franchise tax and the utility gross receipts tax.

Rhode Island. The governor asked that the state continue to review the possibilities of reducing or eliminating certain taxes, and that continued cuts be made in the state income tax. (His proposal to eliminate the corporate net worth tax was subsequently approved by the legislature.) Later in the session the governor asked the legislature to raise the cigarette tax by one cent, to provide new money for a drug prevention and rehabilitation program.

South Carolina. The governor proposed no tax increases. He suggested that, in view of the state's relatively high industrial property tax rates, local governments be given the authority to negotiate fees in lieu of property taxes. He also urged restoration of the capital gains differential in income tax rates. A separate tax proposal would authorize 1% (optional) county sales taxes, with 100% of the proceeds dedicated to county property tax reductions.

South Dakota. The governor proposed, and the legislature approved, the early phase-out of a one-cent sales tax increase enacted last year. The extra tax was repealed effective March 1, two months earlier than scheduled. Farm groups have urged the imposition of a corporate income tax in South Dakota (one of five states without such a tax), with the proceeds dedicated to relieving property taxes and raising teachers' salaries. In addition, an increase in the motor fuels tax rate from 13 cents to 18 cents a gallon, has been approved in the 1988 session.

Tennessee. The governor recommended an increase in property tax exemptions for low-income elderly homeowners. He requested no higher taxes.

Texas. The legislature is not convening in 1988.

Vermont. The governor recommended a temporary reduction in the personal income tax, from 25% to 24% of Federal tax liability and the enactment of an earned income tax credit. She also proposed a two-cent increase in the gasoline tax, higher vehicle registration fees, and a weight/distance tax for trucks, excluding milk trucks.

Washington. The legislature held a short, nonbudget, session to consider the governor's supplemental requests for the rest of the current biennium. Lawmakers approved broadening the sales tax base to include prepared food at grocery stores (for $8.1 million in new revenues), and considered increasing the gasoline tax in two steps for $110 million in the first year and $162 million in the second year.

West Virginia. The governor asked for about $97 million in higher taxes through increases in the cigarette and gasoline taxes, along with a new tax on smokeless tobacco. Opposing legislative leaders advanced alternative plans, including a 1% increase in the state sales tax. The budget for fiscal 1989 is frozen at just under $1.5 billion, or $23 million less than the fiscal 1988 budget.

Wisconsin. The governor proposed a wide-ranging plan for property tax relief, to be financed by new state funds from broadening the sales tax base, adjusting the married couple's income tax credit to reflect last year's tax reductions, imposing a tax on the unrelated income of tax-exempt organizations, taxing commercial rents, and using state lottery proceeds. The governor's plan would raise an additional $245 million in 1988-89 and $318 million in 1989-90 for the state. He would also give municipalities the authority to adopt "leisure" taxes of up to 3%. The legislature is also expected to consider raising the motor fuels tax, to generate an extra $21 million a year. In addition, some legislators are pushing for repeal of the 60% exclusion of capital gains from the income tax base and the use of the proceeds for property tax relief.

Wyoming. The governor urged the legislature to support a classified property tax system, to replace the current system, which was declared unconstitutional by the state supreme court. To help balance the forthcoming budget, the governor has proposed higher taxes on cigarettes and malt beverages, and the temporary diversion of some severance taxes to the general fund.